March 1, 2009

To: Members of the Finance Revenue and Bonding Committee

Fr: Sally Miller, Senior Vice-President, American Bankers Association

Re: Testimony regarding Senate Bill 1, An Act Concerning the Preservation and Creation of Jobs in Connecticut

Chairwoman Dailey, Chairman Staples and members of the Committee, my name is Sally Miller and I am a senior vice-president, with the American Bankers Association. I am pleased to be here today to testify on behalf of the ABA and the Connecticut Bankers Association regarding Senate Bill 1. In my testimony, I would like to provide you with a brief update on the TARP program and current regulatory checks on compensation practices. I would like to conclude with a few comments about the unintended consequences of the TARP bonus tax provisions of SB 1.

By way of background, the ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members represent over 95 percent of the industry's $13.1 trillion in assets and employ over 2 million men and women. Just as with the CBA, our members range from small community banks to some of the largest banks in the country. In fact, the majority of our members are banks with less than $125 million in assets.

The ABA and the CBA support the goals of SB 1, namely to preserve jobs and encourage job creation through the establishment of a State small business assistance program. As President Obama recognized in his recent State of the Union address, it is imperative that we find ways to ensure that small businesses get the credit they need. Small businesses of all kinds—including banks—are suffering from the severe economic recession. I would encourage the members of the Committee to work with the CBA on the program details as their members can bring to the table a wealth of knowledge, both as lenders to small businesses and as small businesses themselves.

TARP investments in banks—primarily through the Capital Purchase Program (CPP)—are providing US taxpayers with a significant return. To date, over $247 billion has been invested in more than 700 banks of all sizes, earning Treasury $15.6 billion in interest and dividends on its investment. Of the $247 billion invested, $174.7 billion has been repaid and Treasury projects that bank programs will earn taxpayers a profit of at least $19 billion.

The reason why US taxpayers are receiving such a significant return on their investment is because the CPP was a direct investment of capital targeted to healthy financial institutions. Designed in the fall of 2008, the program was intended, among other things, to instill stability in the nation's financial system and to prevent severe contraction in lending that is typical of most recessions.

The CPP has helped support lending through this market disruption and the longest recession since the Great Depression. Typically, a recession is accompanied by a severe contraction in lending; however, the TARP's bank programs have supported banks' continued efforts to make prudent loans in their communities. According to US government reports, over 80 percent of CPP participants used their capital injections in part to directly support lending and the 10 largest CPP participants increased total originations 17 percent and total average outstanding loan balances 13 percent from December 2008 to December 2009. These funds were also used to bolster bank reserves that are required by the regulators to absorb losses and investments in agency mortgage-backed securities which provided immediate support to funding markets which had largely disappeared.

The $19 billion plus profit for taxpayers points out the gross misperception that has been created about the TARP investments in banks. The CPP program and other bank programs were designed to be used by healthy banks. The non-bank TARP money was designed to support troubled institutions, like AIG, General Motors and Chrysler. This confusion between capital for healthy banks and bailouts for weak firms continues to be a source of great frustration to banks, but more importantly can lead to confusion about policy.

The misconception continues with respect to bank compensation practices. Compensation is generally paid out of income earned, not capital, and all federal banking regulators prohibit, as an unsafe and unsound practice, excessive compensation arrangements. State and federal banking regulators conduct on-site examinations and inspections to ensure that a bank does not engage in any unsafe and unsound practice, including paying compensation that would cause the bank's capital to be impaired.

Public misconception about compensation practices at banks, generally reinforced by press reports concerning pay practices at those troubled non-bank firms that had taken TARP money, led to the enactment of onerous executive compensation and burdensome corporate governance provisions applicable to all entities participating in the TARP program, including the healthy banks whose participation had been strongly encouraged by the government in the first place.

These restrictions included, among other things, a prohibition on cash bonuses for senior executives, strict limits on deferred restricted stock grants and golden parachute payments, and an ability for TARP firms to recoup or "clawback" bonuses paid, under certain circumstances. Significant oversight responsibility was vested in the Treasury Department's Special Master or Pay Czar.

The Office of the Special Inspector General for TARP has reported that the retroactive application of these executive compensation provisions has caused firms to lose senior employees to "foreign and domestic competitors who are not under CPP compensation restrictions." These compensation restrictions have also had a negative impact on firm recruitment efforts.

Our members continue to tell us that they are experiencing a talent drain at their firms and that that drain is not limited to the senior officers specifically impacted by the TARP compensation restrictions. These employees are leaving for opportunities at industries where compensation issues are not in the collective bull's eye of federal and state authorities.

Iit is for this reason that the ABA recently encouraged the federal banking regulators to consult with other authorities when issuing guidance directed to bank bonuses. Given the global nature of financial services, coordination with international and other domestic authorities on compensation issues is central to the banking industry's continued ability to retain and attract talented employees.

Moreover, retroactively moving the goalposts sends an ominous signal to institutions that may be considering participating in programs designed to get our economy moving. For example, many community banks have expressed interest in the small business capital investment program outlined by the President in his State of the Union address. Understandably, community banks are concerned that this program may go the way of the TARP program with after-the-fact restrictions being added.

The ABA and CBA respectfully urge the Committee to consider these and other unintended consequences of specifically targeting the employees of entities—entities that were strongly encouraged by the government to participate in the bank TARP programs--for special tax treatment. I would like to thank the members of the Committee for the opportunity to testify here today. I am happy to answer any questions the Committee may have.

Administration Officials: Bank Programs Are Profitable

President Obama

"While we know that we will not escape the worst financial crisis in decades without some losses to the taxpayers, it is worth noting that in the first round of repayments from these companies, the government has actually turned a profit." *December 8, 2009*

http://www.whitehouse.gov/the-press-office/remarks-president-job-creation-and-economic-growth

"In fact, because of our stewardship of this program, and the transparency and accountability we put in place, TARP is expected to cost the taxpayer at least $200 billion less than what was anticipated just this summer. And the assistance to banks, once thought to cost the taxpayers untold billions, is on track to actually reap billions in profit for the taxpaying public. This gives us a chance to pay down the deficit faster than we thought possible and to shift funds that would have gone to help the banks on Wall Street to help create jobs on Main Street." *June 9, 2009*

http://blogs.abcnews.com/politicalpunch/2009/06/potus-touts-tarp-repayment-.html

Treasury Secretary Geithner

"TARP programs have already generated significant income – roughly $15 billion – which has been used to pay down the debt. Our outstanding equity investments continue to generate substantial income through dividends. And we are adding to the taxpayer's return by auctioning warrants. Last week, for example, we raised nearly $150 million from the sale of Capital One warrants. We expect substantial income from additional warrant sales over the next few weeks.

However, we do not expect all TARP investments to generate positive returns. There is a significant likelihood that we will not be repaid for the full value of our investments in AIG, GM, and Chrysler. But here too the outlook has improved. We now expect these institutions to repay $14 billion more than was originally projected."

"In September, Treasury ended its Money Market Fund Guarantee Program, which guaranteed at its peak over $3 trillion of assets. The program incurred no losses, and generated $1.2 billion in fees."

December 10, 2009

http://treasury.gov/press/releases/tg437.htm

Treasury Press Release On Profitability of Programs

"Today, the U.S. Department of the Treasury received full repayment on its Troubled Asset Relief Program (TARP) investments in Bank of America in the sum of $45 billion, bringing the total amount of repaid TARP funds to $118 billion. Treasury now estimates that total bank repayments could reach up to $175 billion by the end of 2010, cutting total taxpayer exposure to the banks by almost three-quarters from the peak.

Treasury currently estimates that every one of its programs aimed at stabilizing the banking system – the Capital Purchase Program, the Targeted Investment Program, the Asset Guarantee Program, and the Consumer and Business Lending Initiative -- will earn a profit thanks to dividends, interest, early repayments, and the sale of warrants. Total bank investments of $245 billion in FY2009 that were initially projected to cost $76 billion are now projected to bring a profit of $19 billion. Taxpayers have already received about $15 billion in revenue through interest, dividends, and the sale of warrants, and that profit could be considerably higher as Treasury sells additional warrants in the weeks ahead." December 9, 2009

http://treasury.gov/press/releases/tg436.htm

Treasury TARP Warrant Disposition Report

"To date, the disposition of warrants has succeeded in significantly increasing taxpayer returns on the CPP preferred investments that have been repaid. As of December 31, 2009, Treasury has received $4 billion in gross proceeds on the disposition of warrants in 34 banks, consisting of (i) $2.9 billion from repurchases by the issuers at agreed upon fair market values and (ii) $1.1 billion from auctions.1 For those 34 institutions, Treasury received an absolute return of 3.1% from dividends and an added 5.7% return from the sale of the warrants for a total absolute return of 8.8%.2 These returns are not predictive of the eventual return on the entire CPP portfolio." *January 20, 2010*

Herbert M. Allison, Jr., Assistant Secretary for Financial Stability

"With the recent announcements of repayments by Bank of America, Citigroup, and Wells Fargo, banks will have soon repaid nearly two-thirds of the total amount invested in banks under the program. We also expect a positive return from the government's investments in banks. Investments are generating more income than previously anticipated – more than $15 billion in income so far – and we expect substantial additional income going forward."

"Ending the financial crisis is not primarily about helping banks, but about restoring the flow of credit to consumers and businesses and alleviating the real hardships that Americans face every day. Healthy and vibrant financial institutions are critical for this, as they are the key sources of a range of financial services that we depend on every day. Without healthy banks, consumers cannot access the credit they need to buy a home, finance an education, manage everyday expenses or make other financial commitments. Small businesses cannot buy the new equipment, raw materials and inventory that they need to expand. Larger businesses cannot make the continuous adjustments required to function in a changing global marketplace.

It is with these goals in mind that we have created the programs under the TARP and the Financial Stability Plan." *December 17, 2009*

FDIC Chairman Sheila Bair

"The TLGP program has been a moneymaker for us," FDIC chief Sheila Bair said this month in Senate testimony. "We've collected over $7 billion in payments from it, and we've had no losses." *May 2009*

http://money.cnn.com/2009/05/12/news/fdic.guarantee.fortune/